No. 95-1402

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1995

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

ESTATE OF OTIS C. HUBERT, DECEASED, C & S SOVERAN TRUST COMPANY (GEORGIA) N.A., A NATIONAL BANKING ASSOCIATION, CO-EXECUTOR,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether, in calculating the taxable estate for purposes of the federal estate tax, payment of post-death estate administration expenses out of post-death estate income reduces the marital and charitable deductions for date-of-death value bequests which are allowed by the Internal Revenue Code, 26 U.S.C. §§ 2055 and 2056, when such expenses are permitted by state law and the testamentary documents to be paid out of post-death income of the estate.

TABLE OF CONTENTS

	Page
Question Presented	i
Table of Contents	ii
Table of Citations	ii
Opinions Below	1
Statement of Jurisdiction	1
Statutes and Regulations Involved	1
Statement of the Case	7
Reasons for Denying the Writ	19
Conclusion	28

TABLE OF CITATIONS

Cases Cited:

Alston v. United States, 349 F.2d 87 (5th Cir. 1965) 19, 20, 21, 23

Arrowsmith v. Commissioner, 344 U.S. 6 (1952) 25

Ballantine v. Tomlinson, 293 F.2d 311 (5th Cir. 1961) 19, 20, 21, 23

Blair v. Commissioner, 300 U.S. 5 (1937) 20

Page

Burke v. United States, 994 F.2d 1576 (Fed. Cir.), *cert. denied*, 114 S. Ct. 546 (1993) 10, 23, 24, 25

Citizens & Southern National Bank v. Haskins, 254 Ga. 131, 327 S.E. 2d 192 (1985) 18

Estate of Roney v. Commissioner, 294 F.2d 774 (5th Cir. 1961), *aff'g per curiam*, 33 T.C. 801 (1960) . 19, 20, 21, 23

Estate of Warren v. Commissioner, 981 F.2d 776 (5th Cir. 1993) 21

Fisher v. United States, 28 Fed. Cl. 88 (1993) 23

International Tel. & Tel. Corp. v. Alexander, 396 F. Supp. 1150 (D. Del. 1975) 26

Maass v. Higgins, 312 U.S. 443 (1941) 8

Morgan v. Commissioner, 309 U.S. 78 (1940) 20

Estate of Hubert v. Commissioner, 63 F.3d 1083 (11th Cir. 1995), *aff'g*, 101 T.C. 314 (1993) 1, 10, 15, 16, 17, 20, 22, 27

Estate of Luehrmann v. Commissioner, 287 F.2d 10 (8th Cir. 1961) 9

Estate of Street v. Commissioner, 974 F.2d 723 (6th Cir. 1992), *aff'g in part & rev'g in part*, 56 T.C.M. (CCH) 774 (1988) 10, 16, 17, 22, 23, 24, 25

Contents

	Page
Inverworld, Ltd. v. Commissioner, 979 F.2d 868 (D.C. Cir. 1992)	26
St. Pierre v. United States, 319 U.S. 41 (1943)	26
Williams v. Zbaraz, 448 U.S. 358 (1980)	26
Statutes Cited:	
26 U.S.C. § 212	1, 11, 12
26 U.S.C. § 641(b)	2
26 U.S.C. § 642(g)	2, 9, 11, 12, 15
26 U.S.C. § 2001	8
26 U.S.C. § 2031	8
26 U.S.C. § 2053	9, 15
26 U.S.C. § 2053(a)	3
26 U.S.C. § 2053(a)(2)	11
26 U.S.C. § 2054	15
26 U.S.C. § 2055	i, 3, 8, 15
26 U.S.C. § 2056	i, 4, 8, 15, 18

Contents

	Page
26 U.S.C. § 2056(a)	8
26 U.S.C. § 2056(b)(4)	16
26 U.S.C. § 7460(b)	22
28 U.S.C. § 1254(1)	1
28 U.S.C. § 2111	26
28 U.S.C. § 2201	26
GA. CODE ANN. § 53-15-3 (Michie 1982)	11
United States Constitution Cited:	
U.S. CONST. Art. III § 2, cl. 2	26
Rules Cited:	
FED. R. APP. PROC. 35(a)	19
TAX CT. R. PRAC. & PROC. 91(a)(1)	14
TAX CT. R. PRAC. & PROC. 91(e)	14
TAX CT. R. PRAC. & PROC. 142(a)	14, 27
Other Authorities Cited:	
26 C.F.R. § 20.2055-1(a)	8

Page

26 C.F.R. § 20.2056(b)-4(a) 5, 8, 15, 16, 27

26 C.F.R. § 20.2056(b)-5(f)(1) 6, 27

26 C.F.R. § 20.2056(b)-5(f)(4) 6, 17

26 C.F.R. § 20.2056(b)-7(d)(2) 17

Rev. Rul. 69-56, 1969-1 C.B. 224 16

Colburn, Englbrecht & Vollmers, *Administrative Expenses and the Marital Deduction*, 72 TAXES 412 (1994) 18

Hand, *Eulogy of Thomas Walter Swan*, 57 YALE L.J. 167 (1947) 24

Pennell, 843 TAX MANAGEMENT ESTATES, GIFTS & TRUSTS PORTFOLIO: ESTATE TAX MARITAL DEDUCTION (BNA) at A-29 ..... 18, 25

Schlenger, Madden & Hayes, *TC Reaffirms Its Position That Marital Deduction Is Not Reduced by Administration Expenses*, 21 ESTATE PLANNING 112 (1994) 18

TAX CT. RPTR. (CCH) DOCKETS, PETITIONS, INDEX at 9215-9239 25

Page

APPENDIX

Appendix A — Stipulation of Facts 1a

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eleventh Circuit (Pet. App. 1a-23a) is reported at 63 F.3d 1083 (1995). The opinion of the court of appeals on rehearing (Pet. App. 24a-25a) is not reported. The opinion of the United States Tax Court (Pet. App. 26a-79a) is reported at 101 T.C. 314 (1993).

STATEMENT OF JURISDICTION

The judgment of the court of appeals was entered on September 12, 1995. The petition for rehearing with suggestion for rehearing *en banc* was denied on December 5, 1996. Pet. App. 24a-25a. The petition for writ of certiorari was filed on March 4, 1996. Petitioner[1] seeks to invoke the jurisdiction of this Court under 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

1. 26 U.S.C. § 212 provides:

> In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year —
>
> (1) for the production or collection of income;
>
> (2) for the management, conservation, or maintenance of property held for the production of income; or

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1. In order to avoid confusion between the petitioner in the United States Tax Court case below (the Estate of Mr. Hubert), and the petitioner for writ of certiorari in this Court (the Commissioner of Internal Revenue), the latter shall be referred to herein as "the Commissioner."

(3) in connection with the determination, collection or refund of any tax.

2. 26 U.S.C. § 641(b) provides:

COMPUTATION AND PAYMENT. — The taxable income of an estate or trust shall be computed in the same manner as in the case of an individual, except as otherwise provided in this part. The tax shall be computed on such taxable income and shall be paid by the fiduciary.

3. 26 U.S.C. § 642(g) provides:

DISALLOWANCE OF DOUBLE DEDUCTIONS.— Amounts allowable under section 2053 or 2054 as a deduction in computing the taxable estate of a decedent shall not be allowed as a deduction (or as an offset against the sales price of property in determining gain or loss) in computing the taxable income of the estate or of any other person, unless there is filed, within the time and in the manner and form prescribed by the Secretary, a statement that the amounts have not been allowed as deductions under section 2053 or 2054 and a waiver of the right to have such amounts allowed at any time as deductions under section 2053 or 2054. This subsection shall not apply with respect to deductions allowed under part II (relating to income in respect of decedents).

4. 26 U.S.C. § 2053(a) provides:

GENERAL RULE. — For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts —

(1) for funeral expenses,

(2) for administration expenses,

(3) for claims against the estate, and

(4) for unpaid mortgages on, or any indebtedness in respect of, property where the value of the decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the gross estate,

as are allowable by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered.

5. 26 U.S.C. § 2055 provides, in relevant part:

(a) IN GENERAL. — For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers —

* * *

(2) to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes. . . .

* * *

(d) LIMITATION ON DEDUCTION. — The amount of the deduction under this section for any transfer shall not exceed the value of the transferred property required to be included in the gross estate.

* * *

6. 26 U.S.C. § 2056 provides, in relevant part:

(a) ALLOWANCE OF MARITAL DEDUCTION. — For purposes of the tax imposed by section 2001, the value of the taxable estate shall, except as limited by subsections (b) and (c), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

* * *

(b)(4) VALUATION OF INTEREST PASSING TO SURVIVING SPOUSE. — In determining for purposes of subsection (a) the value of any

interest in property passing to the surviving spouse for which a deduction is allowed by this section —

(A) there shall be taken into account the effect which the tax imposed by section 2001, or any estate, succession, legacy, or inheritance tax, has on the net value to the surviving spouse of such interest; and

(B) where such interest or property is encumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such encumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined.

7. 26 C.F.R. § 20.2056(b)-4(a) provides, in relevant part:

Marital deduction; valuation of interest passing to surviving spouse. —

(a) *In general.* The value, for the purpose of the marital deduction, of any deductible interest which passed from the decedent to his surviving spouse is to be determined as of the date of the decedent's death. . . . The marital deduction may be taken only with respect to the net value of any deductible

> interest which passed from the decedent to his surviving spouse, the same principles being applicable as if the amount of a gift to the spouse were being determined. In determining the value of the interest in property passing to the spouse account must be taken of the effect of any material limitations upon her right to income from the property. An example of a case in which this rule may be applied is a bequest of property in trust for the benefit of the decedent's spouse but the income from the property from the date of the decedent's death until distribution of the property to the trustee is to be used to pay expenses incurred in the administration of the estate.

8. 26 C.F.R. §§ 20.2056(b)-5(f)(1) and -5(f)(4) provide, in relevant part:

> **Marital deduction; life estate with power of appointment in surviving spouse.**
>
> * * *
>
> (f) *Right to Income.*
>
> (1) If an interest is transferred in trust, the surviving spouse is "entitled for life to all of the income from the entire interest or a specific portion of the entire interest," . . . if the effect of the trust is to give her substantially that degree of beneficial enjoyment of the trust property during her life

> which the principles of the law of trusts accord to a person who is unqualifiedly designated as the life beneficiary of a trust.
>
> * * *
>
> (4) Provisions granting administrative powers to the trustee will not have the effect of disqualifying an interest passing in trust [for want of entitlement to "all of the income"] unless the grant of powers evidences the intention to deprive the surviving spouse of the beneficial enjoyment required by the statute. Such intention will not be considered to exist if the entire terms of the instrument are such that the local courts will impose reasonable limitations upon the exercise of the powers. Among the powers which if subject to reasonable limitations will not disqualify the interest passing in trust [for want of entitlement to "all of the income"] are the power to determine the allocation or apportionment of receipts and disbursements between income and corpus. . . .

STATEMENT OF THE CASE

This case concerns the federal estate tax liability of the Estate of Otis C. Hubert, formerly a resident of Georgia ("Mr. Hubert"). Mr. Hubert died in 1986, leaving an estate greater than

$30,000,000 which was divided between charity and his family. A Will contest ensued and was ultimately settled based upon an approximately equal division between the Hubert family and charity.

1. Upon the death of a decedent who had sufficient property value to invoke the estate tax, his "gross estate," less various deductions, is subject to tax. 26 U.S.C. § 2001. The amount of the gross estate is determined by the value of the decedent's property "at the time of his death." 26 U.S.C. § 2031. As well, 26 U.S.C. § 2056 provides for a deduction from the gross estate for certain property passing to the surviving spouse, known as the "marital deduction."[2] The measure of the marital deduction is again the value of the property passing to the surviving spouse "as of the date of the decedent's death." 26 C.F.R. § 20.2056(b)-4(a), *interpreting* 26 U.S.C. § 2056(a). The gross estate is also reduced by charitable contributions, with the measure of those contributions once again being "the value of property included in the decedent's gross estate," *i.e.*, the date-of-death value. 26 C.F.R. § 20.2055-1(a), *interpreting* 26 U.S.C § 2055. The object of these date-of-death valuations is to provide a uniform standard for measuring the property that comes into the estate and the property that leaves the estate, providing symmetry from an inclusion and deduction standpoint.

Neither the date-of-death value of the property going into an estate nor the date-of-death value of that same property going out of an estate is embellished by post-death income of the estate; such values would then no longer be "date-of-death." *Maass v. Higgins*, 312 U.S. 443, 448-449 (1941). Consequently, post-death expenses properly paid out of that post-death income cannot and should not alter the date-of-death value of the

2. The property making up the marital deduction is included in the estate of the surviving spouse, if owned by her (or deemed to be owned by her) at the date of her death.

property going into the estate or the date-of-death value of that same property going out of the estate.

The administration of a decedent's estate is a process that occupies a span of time. As a consequence, many estates — especially complicated estates or those involved in litigation — will be subject to the income tax on estates provided by Subchapter J of the Internal Revenue Code during the period of administration. Such estates file a federal fiduciary income tax return (Form 1041), reporting their income and expenses and paying income tax on any net income.

In computing that income tax liability, 26 U.S.C. § 642(g) bestows upon every estate the flexibility of deducting estate administration expenses accrued post-death either on the estate tax return (Form 706) or the estate's income tax return (Form 1041). 26 U.S.C. §§ 2053, 642(g). An estate's choice of where to deduct post-death administration expenses is subject to certain restrictions. First, no "double deduction" may be claimed, and the estate must elect which return is to be used. Thus, administration expenses can be deducted either on the estate tax return or on the estate's income tax return.[3] Second, when estate corpus — *i.e.*, the value of the estate existing as of the date-of-death — is actually used to pay administration expenses or is required to be so used by state law or the testamentary documents, that corpus no longer exists and thus cannot be used to fund the marital, charitable or any other estate tax deduction. *Estate of Luehrmann v. Commissioner*, 287 F.2d 10, 12-13 (8th Cir. 1961).

However, when neither state law nor the controlling

3. The "no double deduction" statute, 26 U.S.C. § 642(g), does not purport to speak to the computation of the marital or charitable estate tax deductions.

testamentary documents create any obligation to pay post-death administration expenses from estate corpus, no diminution of the marital, charitable or other estate tax deductions need occur if the expenses are paid from post-death income of the estate.[4] For this reason, the court of appeals in this case held that neither the date-of-death value of the property going into the estate nor the date-of-death value of the property going out of the estate is diminished by the authorized use of that post-death income to pay post-death expenses, provided that the payment is authorized by state law and the testamentary documents. *Estate of Hubert v. Commissioner*, 63 F.3d 1083 (11th Cir. 1995), *aff'g* 101 T.C. 314 (1993).

2. Mr. Hubert's Will, executed in January 1982, left the residue of his estate in trust, the income of which was to be paid to his wife, with the remainder to charity. One of three codicils removed a general power of appointment that had been granted to Mr. Hubert's wife in his Will.

After five years of litigation among Mr. Hubert's family, his

4. As the Tax Court established in its first footnote, 101 T.C. at 315 n.1 (Pet. App. at 26a), the single most important distinction in this case lies in not confusing, as the Commissioner has throughout this case, the concept of "marital/charitable share" or "marital/charitable portion" with the very different concept of "marital/charitable deduction." The former terms refer to total assets passing to the surviving spouse or charity under the settlement agreement (including both date-of-death value of estate *corpus* and the post-death net *income*), whereas the latter term refers only to the date-of-death value of the estate *corpus* passing to the spouse or charity. That same confusion tripped up both the Sixth Circuit in *Estate of Street v. Commissioner*, 974 F.2d 723, 727 (6th Cir. 1992), and the Federal Circuit in *Burke v. United States*, 994 F.2d 1576 (Fed. Cir.), *cert. denied*, 114 S. Ct. 546 (1993). Both courts assumed that because income increased the marital portion, expenses paid with that income decreased the marital deduction. As shown above, that assumption does violence to the date-of-death concept built into the inclusion and deduction computations.

nephew (who drafted the Will and codicils) and the Cobb County district attorney and the Georgia Revenue Commissioner as representatives of the charitable beneficiaries, the Cobb County Probate Court entered an Order which disposed of the residuary estate and all codicil provisions related to the residuary in a manner different than the Will. In lieu of the Will, the Order divided the entire residuary estate (including corpus and income) between the marital and charitable shares ("Marital Share" and "Charitable Share"). The Marital and Charitable Shares included both estate corpus in existence as of the date-of-death and post-death income earned on that corpus. Just as post-death income had been allocated between the two Shares, so were post-death administration expenses allocated between the Marital and Charitable Shares.

Under Georgia probate law, an executor may charge payments of administration expenses either against the income of the estate or against corpus, if the Will so provides. GA. CODE ANN. § 53-15-3 (Michie 1982). In this case, Mr. Hubert's Will authorized the executors "to charge any expense against income or principal or apportion the same." Acting pursuant to this authority, the executors charged $506,989 of administration expenses against corpus, and as permitted by 26 U.S.C. § 2053(a)(2), those charges were deducted from the gross estate for purposes of the federal estate tax. All other administration expenses were charged by the executors against the post-death income earned by the estate and were deducted from that income during the period of administration for purposes of the federal income tax. 26 U.S.C. § 212.

In accordance with the dictates of 26 U.S.C. §§ 642(g) and 2053(a)(2), the executors of Mr. Hubert's estate reduced the amount of the marital and charitable deductions claimed on the estate tax return by the amount of administration expenses charged against corpus, since those expenses reduced corpus

existing as of the date-of-death. Because post-death administration expenses paid out of post-death income did not and could not reduce the date-of-death valuation of the corpus, the executors did not make such a reduction for the administration expenses charged against post-death income; the executors deducted those expenses on the estate's income tax return pursuant to 26 U.S.C. §§ 212 and 642(g).

3. An example based upon the values in this case best sets forth the issue. Assume that the stipulated value of the gross estate on the date-of-death was $30 of corpus, that $2 of that corpus was used to pay administration expenses, and that the remaining $28 was split evenly between the spouse and charity, with actual corpus distributions to each of $14. This accounts for the entire $30. Assume further that $6 of post-death income is earned by the estate and that unanticipated additional administration expenses of $4 are incurred. These additional expenses are paid out of the $6 of income, leaving a net income of $2, all of which is reported on the estate's fiduciary income tax return (Form 1041). What comes in, goes out: the estate balances.

If the estate were promptly closed and the assets distributed to a trust for the benefit of the spouse and charity, the trust would simply report its income and expense on the trust's fiduciary income tax return. The estate would have no estate tax due, providing symmetry by fully accounting for the date-of-death corpus in distributions which qualified for the marital and charitable estate tax deductions. In turn, the true net income of the estate — the post-death income and administration expenses paid therefrom — would be reported by the trust on the fiduciary income tax return. Again, what comes in, goes out.

However, when, as here, closing of the estate takes some time, the result of the Commissioner's position is as follows:

despite the fact that $14 of date-of-death corpus is actually distributed to the spouse and $14 of date-of-death corpus is actually distributed to charity, the federal estate tax will artificially assume that only $12 of corpus passes to each:

	$30	gross estate
-	2	administration expenses paid from corpus
-	4	administration expenses paid from income
	$24	estate remaining for distribution to beneficiaries
+	2	division of estate equally between spouse and charity
	$12	distribution to each of spouse and charity

This view leaves $4 of corpus missing from the gross estate, yet subject to estate tax. In other words, the $30 date-of-death corpus is distributed $2 for expenses paid from corpus, $12 to the spouse and $12 to charity, for a total of only $26. Thus, $4 of corpus disappears, but not before it is taxed. In order to avoid having this disappearing residuary taxed on the estate tax return, the executor is forced to deduct the $4 of administration expenses paid from post-death income on the estate tax return, rather than the estate's income tax return. The result, as to the estate's income tax return, is an illegal income tax on gross, not net, income. Thus, the Commissioner's approach — examined from either viewpoint — results in a distortion: what comes in does not go out for estate tax purposes (producing the disappearing residuary described above) or does not go out for income tax purposes (producing an illegal tax on gross income).

4. After issuing a notice of estate tax deficiency on other grounds, the Commissioner raised a new issue in the Tax Court.

She contended that the marital and charitable deductions had been overstated by the total administration expenses, without regard to the source of their payment, the effect of state law, or the effect of any elections made by the executors. Because this new issue was not set forth in the notice of estate tax deficiency, the Commissioner bore the burden of proof on all factual matters. TAX CT. R. PRAC. & PROC. 142(a).

5. In the Tax Court, the Commissioner conceded the grounds set forth in the notice of deficiency and went to trial on the new issue. As part of her trial preparation, the Commissioner stipulated that the marital deduction was $11,896,597 and that the charitable deduction was $11,840,385.[5] Stipulation ¶¶ 57-58, Resp. App. 2a-5a. In making that stipulation, the Commissioner reduced the marital and charitable deductions by interest she deemed had been implicitly earned on the assets of Mr. Hubert's estate — by $2,847,541 and $3,098,001, respectively. Finding no statutory support for such a reduction, the Tax Court refused to condone the Commissioner's concept of imputed interest earned on the assets of Mr. Hubert's estate; the Commissioner did not appeal this determination. When the Commissioner's stipulations are adjusted by the implicit interest issue which she lost in the Tax Court, the correct stipulation produces a marital deduction of $14,744,138 and a charitable deduction of $14,938,386. Stipulation ¶¶ 57-58, Resp. App. 2a-5a. On these

5. The Tax Court rules require that all parties "stipulate, to the fullest extent to which complete or qualified agreement can or fairly should be reached, all matters not privileged which are relevant to the pending case, regardless of whether such matters involve fact or opinion or the application of law to fact. . . ." TAX CT. R. PRAC. & PROC. 91(a)(1). "A stipulation shall be treated, to the extent of its terms, as a conclusive admission by the parties to the stipulation, unless otherwise permitted by the Court or agreed upon by those parties. The Court will not permit a party to a stipulation to qualify, change, or contradict a stipulation in whole or in part. . . ." TAX CT. R. PRAC. & PROC. 91(e).

stipulations, the sum of the marital and charitable deductions exceeds the date-of-death residuary corpus. Hence, the Commissioner here seeks review of a position which will have no impact upon this case.

6. In a reviewed decision adopted verbatim by the majority of the court of appeals, the Tax Court held that the marital and charitable deductions were not reduced by post-death administration expenses properly allocated to post-death income pursuant to Georgia law and Mr. Hubert's Will. The Tax Court properly recognized that administration expenses "are incurred and accrued during administration and should not be confused with claims against the estate which existed and accrued at the date of death." 101 T.C. at 323. This conclusion does not lead to a double deduction forbidden by 26 U.S.C. § 642(g), which prohibits a deduction under 26 U.S.C. §§ 2053 or 2054 for an amount deducted on the estate's income tax return. Instead, the deductions in question are under 26 U.S.C. §§ 2055 and 2056, which the Tax Court pointed out are based on the date-of-death values of the property passing to the spouse and the charitable beneficiaries.

The Tax Court opined that the Commissioner's reliance on 26 C.F.R. § 20.2056(b)-4(a) was misplaced for the same reason that the Commissioner has failed throughout this litigation to mention the title of her own regulation, "Marital deduction; valuation of interest passing to surviving spouse." That regulation is precisely what its title states that it is — a valuation regulation for determining the value of the property passing to the spouse. Based on the facts of the case, the Tax Court found that the right to pay administration expenses out of post-death income was not a material limitation here on the right of the surviving spouse to receive that income. The Commissioner has never contested this fact-finding.

Further, the Tax Court pointed out that, pursuant to 26 U.S.C. § 2056(b)(4) and 26 C.F.R. § 20.2056(b)-4(a), the value of the interest passing to the spouse and the effect of any encumbrance is to be determined "as if the amount of a gift to the spouse were being determined." 101 T.C. at 325. The Tax Court held that, under the rules pertaining to gifts, the payment of administration expenses out of income is not a limitation on the spouse's right to income, a truth recognized by the Commissioner in her own instructions to auditors and taxpayers. 101 T.C. at 325, *citing* Rev. Rul. 69-56, 1969-1 C.B. 224.

The Tax Court rejected the Commissioner's contention that the legislative history of the marital deduction dealing with payment of claims out of an estate's post-death income requires a reduction of the marital deduction when administration expenses are paid out of that income. This legislative history nowhere refers to administration expenses. The Tax Court pointed out that claims against an estate are in existence at the date of death and thus burden the estate's corpus, but administration expenses arise after death and may relate to both corpus and post-death income. Logically, administration expenses may thus be charged to either post-death income or to corpus, while claims must be charged to corpus. 101 T.C. at 326.

The Tax Court disagreed with one prong of the two inconsistent conclusions reached by the Sixth Circuit in *Estate of Street v. Commissioner*, 974 F.2d 723 (6th Cir. 1992), *aff'g in part & rev'g in part* 56 T.C.M. (CCH) 774 (1988), finding the Sixth Circuit's reliance on 26 C.F.R. § 20.2056(b)-4(a) and the legislative history to be misplaced. 101 T.C. at 328-329. The Tax Court disagreed with the Sixth Circuit's analysis that income earned by the estate increases the marital share and presumably the marital deduction, leading to a marital deduction greater than the amount actually distributable if expenses paid from income do not reduce the marital deduction. The Tax Court noted that

income earned on estate property is not included in the gross estate; and "as a result, under section 2056(a), such income does not lead to an increase in the amount of the marital deduction requiring a corresponding decrease for payment of administration expenses chargeable against income of the estate." 101 T.C. at 329.

Rejecting as artificial the Sixth Circuit's distinction in *Estate of Street* that the marital deduction need not be reduced for interest on estate and inheritance taxes paid out of the income of the estate but should be reduced for all other administration expenses, the Tax Court noted that the regulation relied upon by the Sixth Circuit is only an example of a situation in which the rule *may* be applied. That regulation does not purport to exclude interest on estate and inheritance taxes from the broader concept of administration expenses.

Instead, the Tax Court said that the controlling regulation was 26 C.F.R. § 20.2056(b)-5(f)(4). That regulation addresses the marital deduction when, as here, the spouse receives a life estate with a general power of appointment,[6] and it specifically addresses the "right to income" when the executor is given the discretion to pay expenses out of income. The regulation thus states that "the power to determine the allocation or apportionment of receipts and disbursements between income and corpus" is not a condition which will cause the spouse to have a right to less than "all of the income," as required by a general power of appointment trust, "if the local courts will impose reasonable limitations upon the exercise of powers." Coincidentally, these "reasonable limitations" had already been

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6. Under the settlement agreement, the Marital Share is divided between the general power of appointment trust and a qualified terminal interest trust. Principles identical to those contained in 26 C.F.R. § 20.2056(b)-5(f)(4) are applied to a qualified terminal interest trust by 26 C.F.R. § 20.2056(b)-7(d)(2).

litigated by the executor in this case. In the year before Mr. Hubert died, the Georgia Supreme Court held, in *Citizens & Southern National Bank v. Haskins*, 254 Ga. 131, 327 S.E.2d 192 (1985) (citations omitted):

> While there are rules for categorizing items as income or principal, the settlor may authorize the trustee to allocate interests to income which would otherwise be principal and vice versa. . . . When exercising this power the trustee must "act impartially as between income and principal beneficiaries. . . ."

Thus, the Commissioner's own regulation defers to state law in this area. As fortified by that state law, the regulation establishes that the discretion that Mr. Hubert bestowed upon his executors to pay expenses out of income is consistent with Mrs. Hubert's right to "all of the income" of the marital trusts for purposes of 26 U.S.C. § 2056 and does not alter the full marital deduction.

7. Commentators generally agree that the Tax Court's decision in this case is correct. *See* Schlenger, Madden & Hayes, *TC Reaffirms Its Position That Marital Deduction Is Not Reduced by Administration Expenses*, 21 ESTATE PLANNING 112 (1994); Pennell, 843 TAX MANAGEMENT ESTATES, GIFTS & TRUSTS PORTFOLIO (BNA) at A-29; Colburn, Englbrecht & Vollmers, *Administrative Expenses and the Marital Deduction*, 72 TAXES 412, 419 (1994).

REASONS FOR DENYING THE WRIT

The decision of the Eleventh Circuit Court of Appeals is correct. Further, review is not warranted because the stipulations and fact-findings of the Tax Court, unappealed by the Commissioner, prevent a reversal by this Court from having any numerical effect on the estate tax liability of Mr. Hubert's estate.

1. The Commissioner seeks certiorari on the basis of (a) a conflict within the circuit which decided this case and (b) a conflict among the courts of appeals.

a. The purported intra-circuit conflict — the same basis upon which the Commissioner sought *en banc* rehearing — was rejected out of hand by the court of appeals in this case in a per curiam opinion signed by Judge Dubina, who wrote the dissenting opinion in the Eleventh Circuit.[7] Although the Commissioner repeatedly asserts that the court of appeals' decision here is contrary to the binding precedent formed by *Alston v. United States*, 349 F.2d 87 (5th Cir. 1965); *Ballantine v. Tomlinson*, 293 F.2d 311 (5th Cir. 1961); and *Estate of Roney v. Commissioner*, 294 F.2d 774 (5th Cir. 1961), *aff'g per curiam* 33 T.C. 801 (1960), those assertions ignore the reasoning of those courts, which was to follow the controlling state probate law and testamentary provisions. Thus, when different state law property rights exist, different federal estate tax results necessarily follow.

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7. In order to file a petition for *en banc* review, the Commissioner certified to the court of appeals in this case that such an intra-circuit conflict existed. FED. R. APP. PROC. 35(a), *as interpreted by* 11TH CIR. R. 35-6(c) (certification required "that the panel decision is contrary to the following decision(s) of the Supreme Court of the United States or the precedents of this circuit and that consideration by the full court is necessary to secure and maintain uniformity of decisions in this court:"). Accordingly, the Eleventh Circuit faced this issue directly.

As the court of appeals noted here, in the words of the former Chief Judge of the Fifth Circuit[8] (63 F.3d at 1084 n. 1) (citations omitted):

> With due respect to the dissenting opinion, the two cases cited as binding authority are inapplicable in this case.
>
> In *Ballantine v. Tomlinson*, neither the will nor Florida law permitted the expenses there involved to be paid out of income. . . .
>
> Likewise in *Alston v. United States*, though Georgia law permitted it, there was no provision in the will for the payment of the administration expenses there involved from income. . . .
>
> There is nothing in either opinion that would indicate a result contrary to the one the tax court reached in this case.

All of these cases simply stand for the proposition that state law determines the property rights and probate interests of the parties, while federal law determines how those interests are taxed. *Morgan v. Commissioner*, 309 U.S. 78 (1940); *Blair v. Commissioner*, 300 U.S. 5 (1937). In each case, the applicable state law and the governing testamentary instruments called for expenses to be paid out of corpus. Indeed, the decisions of the

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8. Judge Roney, who wrote the majority opinion in the court of appeals in this case, was appointed to the bench in 1970 by President Nixon. As a consequence, he served on the Fifth Circuit for an 11-year period prior to the creation of the Eleventh Circuit, part of that time as Chief Judge. He thus was a member of the court which wrote the opinions in *Alston, Ballantine* and *Roney*.

Fifth Circuit in *Alston, Estate of Roney* and *Ballantine* each relied — at the urging of the Commissioner — upon applicable state law and the governing instruments calling for expenses to be paid out of corpus.

The Fifth Circuit continues to look to state law to determine the property interests of the parties. For example in *Estate of Warren v. Commissioner*, 981 F.2d 776 (5th Cir. 1993), the decedent's Will placed the bulk of her estate into two equal charitable lead residuary trusts. The charities received an annuity payment for 20 years at 8 ½% of the initial value of the trust assets. After 20 years, the trust assets were distributable to Mrs. Warren's children and grandchildren. The administrators of the estate asked the probate court for instructions regarding allocation of administration expenses because, under Texas law, expenses could be charged against either income or principal. The probate court ordered that expenses be charged 72.5% to income and 27.5% to corpus. Thus, the estate deducted 27.5% of the expenses on its estate tax return and the balance on its income tax returns (which is what happened in this case). The Fifth Circuit held that the probate court had applied state law properly in allocating the administration expenses between income and corpus and that, as a result, the administration expense charged to income and deducted on the estate's income tax returns did not reduce the charitable deduction. The *Estate of Warren* decision once again recognizes the controlling effect of state law on property rights.

The supposed intra-circuit conflict thus does not exist. The Fifth Circuit cases are all consistent with the court of appeals' decision in this case. The controlling state law and testamentary provisions in this case permitted the matching of post-death expenses and post-death income. No Fifth Circuit case holds to the contrary in the face of a state statute or Will which permits such a matching.

b. The conflict between this case and the Sixth Circuit opinion in *Estate of Street v. Commissioner*, 974 F.2d 723 (6th Cir. 1992), *aff'g in part and reversing in part* 56 T.C.M. (CCH) 774 (1988), is one which was carefully considered by the Tax Court. Pursuant to the provisions of 26 U.S.C. § 7460(b), because of the Sixth Circuit's opinion, the Chief Judge of the Tax Court directed that the decision in this case be reviewed by the entire court.[9] In this case, 15 of 17 Tax Court judges ruled in favor of the matching principle followed by Mr. Hubert's estate.

The Tax Court's *en banc* decision pinpointed the conceptual misunderstanding of the Sixth Circuit, which is the same conceptual error the Commissioner urges upon this Court (101 T.C. at 329)(citations omitted):

> [W]e take issue with the Court of Appeals' analysis of the effect of income and expenses on the marital share. The court stated that income earned on estate property increases the marital share, and presumably the marital deduction, leading to a deduction greater than the amount distributed if payment of expenses from income does not reduce the marital deduction. However, income earned on estate property is not included in the gross estate. . . . As a result, under section 2056(a), such income does not lead to an increase in the amount of marital deduction requiring a corresponding decrease for payment of administration expenses chargeable against income of the estate.

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9. The United States Tax Court issued 611 opinions in 1993, the year in which it decided this case. Of those 611 opinions, only 11 — or 1.8% — were reviewed decisions.

Fisher v. United States, 28 Fed. Cl. 88 (1993), merely follows *Estate of Street*, adding nothing to the analysis.

Both the Commissioner here and the Sixth Circuit in *Estate of Street* fail to distinguish between the "marital share or marital portion" and the "marital deduction" (and their charitable counterparts). The "share/portion" term refers to the total assets passing to the surviving spouse or to charity under the settlement agreement, and includes both the date-of-death value of estate corpus and the post-death net income. The "deduction" term refers only to the date-of-death value of the estate corpus passing to the spouse and to charity. The Sixth Circuit's confusion of these two concepts led it astray in *Estate of Street*, because the Sixth Circuit assumed that, because income increased the marital share, expenses paid with that income decreased the marital deduction.

In *Burke v. United States*, the Federal Circuit conceded that state law governs the determination of property rights. Indeed, the controlling state law in *Burke* — like the controlling state law in *Alston, Ballantine* and *Roney* — required the payment of expenses out of corpus and thereby forced the same ultimate conclusion reached by the Federal Circuit in *Burke*. *Burke v. United States*, 994 F.2d 1576 (Fed. Cir.), *cert. denied*, 114 S. Ct. 546 (1993). However, the *Burke* court framed the "pertinent question" as "whether payment of administration expenses must be accounted for in computing the value of a taxable estate under federal law for federal estate tax purposes regardless of the actual source of payment." 994 F.2d at 1580. This completely confuses the issue. Neither the marital share nor the charitable share are paid out of the "taxable estate." The relevant inquiry is not what is the taxable estate, but what is the residuary corpus payable to the marital share and the charitable share, which forms the marital and charitable deductions based on date-of-death values.

This misconception of the court in *Burke* leads to an asymmetrical result when expenses are properly charged to and paid from income and the executor elects to claim the administration expenses as an income tax deduction rather than as a deduction in reaching the taxable estate.[10] Because the Federal Circuit in *Burke*, like the Sixth Circuit in *Estate of Street*, was forced to judgment in these convoluted tax matters without the benefit of the Tax Court's exhaustive analysis in its reviewed decision in this case, errors occurred.[11] As one respected commentator has noted:

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10. *See* the example set forth at ¶ 3, pp. 12-13, *supra*.

11. No less an authority than Learned Hand once said:

> In my own case the words of such an act as the Income Tax, for example, merely dance before my eyes in a meaningless procession: cross-reference to cross-reference, exception upon exception — couched in abstract terms that offer no handle to seize hold of — leave in my mind only a confused sense of some vitally important but successfully concealed, purport, which it is my duty to extract, but which is within my power, if at all, only after the most inordinate expenditure of time. I know that these monsters are the result of fabulous industry and ingenuity, plugging up this hole and casting out that net, against all possible evasion; yet at times I cannot help recalling a saying of William James about certain passages of Hegel: that they were no doubt written with a passion of rationality; but that one cannot help wondering whether to the reader they have significance save that the words are strung together with syntactical correctness.

Hand, *Eulogy of Thomas Walter Swan*, 57 YALE L.J. 167, 169 (1947). Judge Hand thus points out the danger of judicial determinations made without an understanding of the tax system integrated as a whole, a problem to which the Sixth Circuit and Federal Circuit succumbed in *Estate of Street* and *Burke*.

> In confusing the amount actually passing to the charity and computation of the federal gross and then taxable estates, the court in *Burke* revealed that it had hardly a clue what was involved in the case. . . .

Pennell, 843 TAX MANAGEMENT ESTATES, GIFTS & TRUSTS PORTFOLIO: ESTATE TAX MARITAL DEDUCTION (BNA) at A-28. The court of appeals here was more astute.

In sum, the appellate decision in *Estate of Street* consists of two internally inconsistent conclusions, while the language relied upon by the Commissioner in *Burke* is *obiter dictum* since the same result is required by state law. The case *sub judice* is the only court of appeals' decision to consider the issue in light of the reviewed Tax Court decision issued subsequent to the conflicting conclusions drawn by the Sixth Circuit in *Estate of Street* and the *dictum* by the Federal Circuit in *Burke*. Hence, no clean conflict exists among the circuits. The issue should await review by this Court until and if a court of appeals chooses a different course after considering the exhaustive analysis of the *en banc* Tax Court.[12]

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12. The 15 Tax Court judges who ruled in favor of Mr. Hubert's Estate have, in the aggregate, 136 years of experience on the bench exclusively handling substantive federal tax disputes. Their appointments honor approximately 295 collective years of prior tax experience in government and in private practice at some of the most prestigious firms in the country. TAX CT. RPTR. (CCH) DOCKETS, PETITIONS, INDEX at 9215-9239.

This is thus an appropriate case to recall the words of Justice Jackson in *Arrowsmith v. Commissioner*, 344 U.S. 6, 12 (1952)(Jackson, J., dissenting):

> I think great deference is due the twice-expressed judgment of the Tax Court. . . . I still think the Tax

(Cont'd)

2. The Commissioner has not chosen the right case to review the issue appealed. As a matter of stipulated fact, no justiciable controversy exists in this case. Based upon the Commissioner's stipulations in the Tax Court, as corrected for the implicit interest discount unsuccessfully argued by the Commissioner and not appealed, the sum of the marital and charitable estate tax deductions in this case exceeds the date-of-death residuary corpus. *See* ¶ 3 at 12-13, *supra*; Stipulation ¶¶ 57-58, Resp. App. 2a-5a. As a consequence, no decision reached by this Court can have any impact on the estate tax due by Mr. Hubert's estate. The Commissioner's perception of an error of law is, at most, academic.

Thus, declining review in this case is consistent with the constitutional limitation on rendition of advisory opinions, U.S. CONST. Art. III, § 2, cl. 2, as well as the statutory preclusions of declaratory judgments in this type of tax case, 28 U.S.C. § 2201, and of appellate court reversals based on harmless error. 28 U.S.C. § 2111. Review in this Court should be granted only when this Court's judgment will have some material effect. *See St. Pierre v. United States*, 319 U.S. 41 (1943). On the basis of stipulated facts, the issue appealed by the Commissioner is a moot point. *Williams v. Zbaraz*, 448 U.S. 358, 367 (1980); *International Tel. & Tel. Corp. v. Alexander*, 396 F. Supp. 1150, 1160-1162 (D. Del. 1975).

3. The Commissioner's perceived question of law turns upon a question of fact that was resolved against the

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(Cont'd)

> Court is a more competent and steady influence toward a systematic body of tax law than our sporadic omnipotence in a field beset with invisible boomerangs.

Accord, Inverworld, Ltd. v. Commissioner, 979 F.2d 868, 875 (D.C. Cir. 1992).

Commissioner in the Tax Court, was not appealed, and is unsuitable for this Court's review. The regulation upon which all of the Commissioner's arguments are bottomed is, as its caption states, a valuation regulation. 26 C.F.R. § 2056(b)-4(a), "Marital deduction; valuation of interest passing to surviving spouse." Valuation is a question of fact. The parties stipulated to the date-of-death value of Mr. Hubert's estate. Stipulation ¶ 50, Resp. App. 1a-2a. That stipulation was not conditioned upon the existence of any discount caused by the payment of estate administration expenses out of the income of the estate, nor did the Commissioner put on any evidence of such a discount, as was her duty based upon her failure to raise that issue in the statutory notice of deficiency.[13] Having reached that stipulation, the Tax Court held that "[o]n the facts before us, we find that the trustee's discretion to pay administration expenses out of income is not a material limitation on the right to receive income. . . ." 101 T.C. at 325. Because of this fact-finding, the Treasury Regulation on which the Commissioner relies, even if applicable, would produce the same result. The Commissioner could not, in light of her stipulation, appeal this fact-finding and did not do so. Thus, no factual predicate exists to merit the legal inquiry appealed.

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13. Based upon 26 C.F.R. §§ 2056(b)-5(f)(1) and -5(f)(4), as a matter of law, there could have been no valuation discount caused by the allocation of administration expenses. In all events, the Commissioner bears the burden of proof on these new issues, since they were not raised in the statutory notice of deficiency. TAX CT. R. PRAC. & PROC. 142(a).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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APPENDIX A — STIPULATION OF FACTS

UNITED STATES TAX COURT

DOCKET NO. 22333-90
JUDGE CLAPP

ESTATE OF OTIS C. HUBERT, DECEASED, CITIZENS & SOUTHERN TRUST COMPANY (GEORGIA) N.A., a national banking association, Temporary Administrator and Nominated Co-Executor,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

STIPULATION OF FACTS

IT IS HEREBY STIPULATED THAT, for purposes of this case, the following statements may be accepted as true, except as qualified herein, and all exhibits referred to herein and attached hereto, are incorporated in this stipulation and made a part hereof. Either party may introduce other and further evidence not inconsistent with the facts herein stipulated or the contents of the exhibits.

* * *

[Excerpts as follows:]

50. The gross estate and specific bequests based upon date of death values are as follows:

Appendix A

CALCULATION OF FORM 706 GROSS RESIDUE BASED ON DATE OF DEATH VALUES

GROSS ESTATE	$ 30,254,219
SPECIFIC BEQUESTS	
SPOUSE	$ (220,747)
CHURCHES	$ (400,000)
OTHERS	$ (30,000)

* * *

57. With respect to the Marital deduction attributable to the residuary estate, the position of the parties as to the amount of residuary corpus actually passing to Mrs. Hubert is as follows:

SECOND AND FINAL SETTLEMENT	**PETITIONER**	**RESPONDENT**
Para. 10 a.(1)	$ 14,390,000	$ 14,390,000
Para. 10 a.(1) and 17(a)		
$ 3,482,262		
($3,299,087)	$ 183,175	$ 183,175
Para. 10 a.(2)	$ 699,376	$ 699,376
Subtotal Marital	$ 15,272,551	$ 15,272,551
DIFFERENCES		
Para. 10 a.(1) (B) (Mar. Inc.)	($ 1,219,603)	
10 a.(2) (Mar. Inc.)	($ 699,376)	

Appendix A

Implicit Interest Income (7% from 6/2/87 to 10/10/90)		($ 2,847,541)
Para. 10 f.(3) Post-Agmt.		
Post Agmt. Inc. ($608,311 through 4/10/91)	No Effect on M.D.	-0-
Post Agmt. Exp. ($548,413 through 9/26/91; $398,269 through 4/10/91)	No Effect on M.D.	($ 548,413)
Allowable Resid. Mar. Ded.	$ 13,353,572	$ 11,896,597*

* **Respondent contends this amount is further reduced by 48 % of any estate taxes and interest due pursuant to Paragraph 10 c. and d. of the Second and Final Settlement Agreement and that the Estate's marital deduction is further limited to the actuarial value of the property passing to the spouse under decedent's will and codicils.**

58. With respect to the charitable deduction attributable to the residuary estate, Petitioner contends that, under Paragraph 10 e. of the Second and Final Settlement Agreement, the remainder of the residuary corpus and income is to be paid over to the charitable trust and that Petitioner is entitled to a charitable deduction of that remainder for Federal Estate tax purposes as follows (based on the assumption that the date of death residuary is $26,224,436 and the corpus allocated to the marital share is $13,353,572):

Date of Death Residuary - Corpus	$ 26,244,436
Allocated to Marital - Corpus	(13,353,572)
Balance to Charity - Corpus	$ 12,870,864

Appendix A

Respondent contends that, under Paragraph 10 of the Second and Final Settlement Agreement, the remainder of the residuary corpus and income is to be paid over to the charitable trust and that the amount of property actually passing to the charities from the residuary estate is as follows:

Adjusted Value as of 4/30/91 (ref. Stip. ¶ 46)	$ 29,176,334
Previously Distributed Inc.	$ 1,219,603
Marital Share before Implicit Int. Inc. and Post Agmt. Expenses	($ 15,272,551)
Share of Unpaid Post Agmt. Admin. Exp.	$ 185,000
Subtotal Charitable	$ 14,938,386
Less Implicit Int. Inc. (7% per annum) from 6/2/87 to 10/10/90	$ 3,098,001
Charitable Deduction Per Resp.	$ 11,840,385**

** **Respondent contends this amount is further reduced by 52 % of any estate tax and interest due pursuant to Paragraph 10 c. and d. of the Second and Final Settlement Agreement and that the Estate's charitable deduction is limited further to the actuarial value of the property passing to the charities under decedent's will and codicils.**

Petitioner maintains with respect to Respondent's calculation of the charitable deduction (a) that the proper starting number is the C&S value as of 4/30/91 of $32,095,354 rather than $29,176,334; (b) that the administrative expenses are payable out of income and do not reduce the residuary corpus

Appendix A

passing to the Charitable Trust; and (c) that the Estate has already dealt with the actual income passing to the Charitable Share as indicated on the Forms 1041.

* * *